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SUBJECT: PUTIN RAISES BANK SECTOR CONCERNS WITH STATE  
COUNCIL

REF: MOSCOW 3949

Summary

1. (SBU) On November 14 President Putin delivered his first ever full-length address dedicated to Russia's banking system. He called for expanded lending to the real economy, especially small and medium business and regionally beyond the lucrative markets of Moscow and St. Petersburg. He pressed for new lending mechanisms, suggesting the establishment of a student loan facility as well as a general expansion in retail banking, possibly using the country's extensive postal system to reach under-served regions. He claimed some early success in the National Priority Project in the agricultural sphere (which is largely focused on credit cooperatives). In many ways, Putin's remarks can be seen as a rallying cry to the Russian banking system in advance of WTO liberalization. End Summary.

First, The Good News

2. (SBU) Addressing the State Council Presidium, a group of governors who advise on coordination and implementation of presidential authority, on November 14, President Putin praised recent vigorous growth of the banking system. Aggregate assets of Russian banks have nearly tripled during the last 3.5 years, and the total retail lending in 2004-2006 increased by a factor of 10.7 to more than RUB 1.5 trillion (USD 56.2 billion). Within the framework of the National Priority Project on agriculture, Putin said farmers and agricultural cooperatives received RUB 28.1 billion (USD 1.06 billion) in bank loans in the first nine months of this year.

Bank System Still Underdeveloped

3. (SBU) Putin said that with just 11 bank offices per 100,000 people, Russia compares poorly to developed countries. Bank offices are especially hard to reach in remote regions, thus leaving "60 million Russians...on the margins" of the banking system. Establishing a more diversified system for providing financial services is vital. Perhaps the existing postal system infrastructure could be used to address the problem.

Excess Demand for Financing

¶4. (SBU) Putin was blunt that the Russian banking system is not meeting increasing demands for financial and credit services. Investment projects in various sectors and regions require long-term, inexpensive and large-size loans. Foreign banks furnish a growing volume of this financing; their share in total lending to the non-financial sector has reached 40 percent. Consolidation of the banking system is required as is the creation of large financial conglomerates to increase competitiveness, especially in view of WTO accession plans. He suggested pension funds might be channeled into the banking system, particularly into mortgage-backed securities.

#### Need for More Flexibility

¶5. (SBU) Putin urged a reduction in the burden of "costly and often excessive administrative requirements and mandatory norms in the financial sector." In return, he expects, banks would improve internal controls and become more transparent. He stressed the need to expand the range of banking products, especially education loans, available to "ordinary clients." Such loans should be available to young people that have neither the collateral nor regular income to make substantial loan payments. He suggested that the state could provide partial guarantees for such loans. Finally, he said that the general population lacks financial literacy. The banking community, in conjunction with federal and local authorities, should educate clients on using the banking system to achieve their personal and professional financial goals. Putin observed that this work would have to start from scratch since only one out of four Russians has a bank account, and less than 10 percent of the populations uses bank cards.

#### Comment

¶6. (SBU) Putin may have been playing fast and loose with the numbers, but his intent seems to have been to send something of shockwave through the Russian banking system. We doubt that foreign banks are responsible for 40% of the lending to the real economy, just as it seems unlikely that there are only 11 banks per 100,000 people (a back of the envelope calculation would put that figure at closer to 14 for Sberbank alone). The Russian banking sector is without question underdeveloped; remote regions are under-served; and the quality of banking services offered by Russian banks is uneven, at best. It is interesting that many of the problems Putin identified were discussed in the now-defunct U.S.-Russian Banking Dialogue, in which former First Deputy Central Bank Chairman Kozlov played a central role. End Comment.

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